

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF INDIANA
SOUTH BEND DIVISION

IN THE MATTER OF)
)
MIDWEST MARKETS LLC) CASE NO. 00-32148 HCD
) CHAPTER 11
)
DEBTOR.)

Appearances:

Jordan Williams, Esq., attorney for debtor, Thorne Grodnik LLP, 228 West High Street, Elkhart, Indiana 46516;

W. Todd Woelfer, Esq., attorney for debtor, May Oberfell & Lorber, 300 North Michigan Street, South Bend, Indiana 46601; and

Brien Crotty, Esq., attorney for Mush & Sons, Inc., 600 1st Source Bank Center, 100 North Michigan Street, South Bend, Indiana 46601-1600.

MEMORANDUM OF DECISION

At South Bend, Indiana, on September 22, 2003.

Before the court is the Motion to Compel Distribution or, in the Alternative, to Partially Disgorge Fees and Expenses, filed by the creditor Mush & Sons, Inc., d/b/a Produce One (“Produce One” or “creditor”), on January 15, 2003. Objections to the motion were filed by the debtor Midwest Markets LLC (“Midwest Markets” or “debtor”) and by counsel for the debtor, Thorne Grodnik, LLP (“Thorne Grodnik”). Following the hearings on the motion and objections thereto, the court took the matter under advisement on June 19, 2003. For the reasons set forth below, the court grants in part and denies in part the creditor’s Motion to Compel.

Jurisdiction

Pursuant to 28 U.S.C. § 157(a) and Northern District of Indiana Local Rule 200.1, the United States District Court for the Northern District of Indiana has referred this case to this court for hearing and determination. After reviewing the record, the court determines that the matter before it is a core proceeding within the meaning of § 157(b)(2)(A) over which the court has jurisdiction pursuant to 28 U.S.C. §§ 157(b)(1)

and 1334. This entry shall serve as findings of fact and conclusions of law as required by Federal Rule of Civil Procedure 52, made applicable in this proceeding by Federal Rules of Bankruptcy Procedure 7052 and 9014. Any conclusion of law more properly classified as a factual finding shall be deemed a fact, and any finding of fact more properly classified as a legal conclusion shall be deemed a conclusion of law.

Background

The parties have agreed that the pertinent underlying facts are undisputed. *See* R. 455, Stipulation of Facts. Midwest Markets filed its chapter 11 petition on June 2, 2000. Produce One filed a Complaint for Turnover of Property on March 15, 2001, seeking to recover trust assets pursuant to Section 5(c) of the Perishable Agricultural Commodities Act (“PACA”), 7 U.S.C. § 499e(c). This complaint initiated adversary proceeding number 01-3032.

The attorney representing the debtor in this bankruptcy was William A. Thorne of the firm Thorne Grodnik.¹ The court approved three interim applications for compensation and reimbursement of expenses in its Orders of August 31, 2000; February 22, 2001; and June 6, 2001. In the last of these interim applications, the court approved compensation in the sum of \$30,870.19. The debtor was ordered to pay 80% of the requested interim compensation plus the expenses, an amount totaling \$24,902.09. On or about June 28, 2001, Thorne Grodnik received \$31,000 from PWNC, LLC, an affiliated company of Midwest Markets, as a loan to Midwest Markets. The purpose of the loan was to pay Thorne Grodnik’s retainer. It was placed in a trust account. On July 18, 2001, \$24,902.09 was transferred from the Thorne Grodnik trust account to its operating account.

On October 23, 2001, Thorne Grodnik, by Mr. Thorne, filed its Application for Compensation and Reimbursement of Expenses, requesting compensation in the amount of \$27,414.50, expenses in the amount of \$2,836.60, and reimbursement of the 20% amount of fee held back from previous applications, \$11,924.50. *See*

¹ On August 7, 2003, W. Todd Woelfer, Esq., of May, Oberfell & Lorber, entered his appearance on behalf of the debtor. *See* R. 465. On August 14, 2003, Thorne Grodnik filed its Motion to Withdraw as counsel of record for the debtor, and the court granted the motion the next day. *See* R. 466, 467.

R. 391. Produce One objected to the application, alleging that its PACA claim had priority over such funds. *See* R. 403. Before the hearing on the objection, however, on November 20, 2001, Midwest Markets and Produce One entered into a Stipulation for Immaterial Modification of Chapter 11 Plan. *See* R. 409. The Stipulation provided that Midwest Markets would set aside \$25,000 to represent a portion of the amount owed by Midwest Markets to Produce One on its PACA claim. Those funds would be paid to Produce One, in partial satisfaction of its PACA claim, in the event that this court found in favor of Produce One on its Complaint.

The plan was confirmed, with the immaterial modification, on December 7, 2001. *See* R. 412. Produce One then withdrew its objection to Thorne Grodnik's application and the court approved the distribution of funds to Thorne Grodnik for fees, expenses, and the 20% holdback fees. *See* R. 420. On December 10, 2001, Thorne Grodnik wrote a letter to Roger Camp, the principal operating officer of Midwest Markets, advising him that the sum of \$25,000 was to be held by the debtor as adequate protection of payment to Produce One in the event a judgment was entered in favor of Produce One in the adversary proceeding.

On April 4, 2002, the court entered on the docket its Judgment and Memorandum of Decision, in the adversary proceeding, in favor of Produce One, finding that Produce One's claim was a valid PACA claim entitled to priority treatment. *See* R. 31, 32, Adv. No. 01-3032. The adversary proceeding was closed on April 25, 2002. However, the parties have stipulated that Midwest Markets has not turned over any funds to Produce One following the court's Judgment, despite written instructions from Thorne Grodnik to do so.

On June 10, 2002, the sum of \$6,706.48 was transferred from the Thorne Grodnik Trust account to its operating account, in partial payment of the fees and expenses approved by the court on December 21, 2001. Thorne Grodnik has no additional sums held in trust for Midwest Markets and has not been paid any additional funds from Midwest Markets. It is still owed in excess of \$35,000 in fees and expenses as approved by the court.

On January 15, 2003, Produce One filed a Motion to Compel Distribution or, in the Alternative, to Partially Disgorge Fees and Expenses. *See* R. 444. It claimed that, pursuant to its chapter 11 plan, Midwest Market was obligated to distribute \$25,000 in funds to Produce One on its PACA claim but has refused to make

that distribution. It asked the court either to compel the distribution or to disgorge the funds used to pay Thorne Grodnik's fees and expenses and to order the delivery of those funds to Produce One as the trust funds to which Produce One is entitled under PACA and under the court's Judgment of April 4, 2002.

Midwest Markets filed its Objection to Motion to Compel on February 27, 2003. *See* R. 448. It asserted that its remaining asset was a claim by the debtor against Moran Foods, which was set for trial in the United States District Court. It indicated that a successful result to that trial would yield the funds to pay Produce One's claim.

An Amended Objection and Response to Motion to Compel was filed on March 21, 2003, by J. Richard Ransel on behalf of Thorne Grodnik. *See* R. 451. He stated that Thorne Grodnik did not object to Produce One's motion to compel the debtor to pay \$25,000, the amount to which it is entitled under the Confirmed Second Amended Plan. He noted that Thorne Grodnik had notified the debtor of its duty to hold those funds undistributed and that the debtor had agreed to do so in the Stipulation for Immaterial Modification of Chapter 11 Plan. Based on the debtor's promise to set aside those funds, the court approved the stipulation and confirmed the debtor's second amended plan; Produce One withdrew its objection to Thorne Grodnik's application for fees and expenses; and the court approved the application. *See id.* at 3-4. At that time, Thorne Grodnik held \$6,706.48 in the trust account set up with the loaned funds to the debtor from PWNC that were earmarked as security for the payment of the firm's fees and expenses. On or about May 7, 2002, those sums were applied from the trust account to pay expenses of \$2,865.47 and fees of \$3,841.01. Thorne Grodnik insisted that it received no money from the debtor that would be proceeds of merchandise provided to the debtor by Produce One and sold by the debtor. *See id.* at 4. It asked that the Motion to Disgorge Fees be denied.

The court conducted hearings on Produce One's motion to compel on April 24, 2003, and on June 18, 2003. The parties agreed that no facts were in dispute. Produce One stated that it held a claim for more than \$41,000 in the debtor's bankruptcy case and that this court had ordered the turnover of that amount to the claimant because Produce One was a PACA claimant. However, the debtor had failed to set aside the \$25,000

it had promised to hold for Produce One, and counsel for Produce One had learned from debtor's new counsel of record, W. Todd Woelfer, Esq., who was not present at the June 18, 2003 hearing, that the debtor had no funds and no prospect for receiving them. For that reason, counsel explained, Produce One now turned for its payments to Thorne Grodnik, the debtor's former attorneys. Produce One asked for disgorgement of the approximately \$6,700 in funds that were available in July 2002 and were moved from the Thorne Grodnik trust account to its operating account. According to Produce One, the PACA lien extended over that \$6,700 amount and over all the debtor's funds after the court entered judgment in its favor on April 4, 2002.

Counsel for Thorne Grodnik responded that the record clearly showed that Mr. Thorne told the debtor to set aside the \$25,000 and that the debtor had agreed to do so. He insisted that the attorney's fees could not be taken by the creditor to fulfill the debtor's obligation. He pointed out that the law firm was unaware of the debtor's inability to fulfill its obligation under the stipulation and noted that the debtor still owes fees and costs to Thorne Grodnik. Produce One suggested that, since the debtor had ignored Mr. Thorne's advice to hold back the \$25,000, the attorney perhaps had an action against the debtor. Counsel for Mr. Thorne insisted that a debtor's attorney should not be held accountable for the misdeeds of the client and that, if the PACA statute forces the firm to disgorge its fees, law firms will be disinclined to represent Chapter 11 debtors, especially those dealing in produce. Thorne Grodnik contended that Produce One had an action to enforce its PACA lien directly against the debtor itself, but not against the debtor's attorney. The court took the matter under advisement.

Discussion

The motion now before the court seeks to compel Midwest Market's compliance with the court's Judgment of March 29, 2002, entered on the docket on April 4, 2002. Although Produce One's claim is for more than \$41,000, the creditor recognizes that, in all likelihood, this debtor cannot pay the claim. It therefore asks that the court compel the turnover of either of two amounts in partial fulfillment of a distribution of PACA trust assets: (1) the \$25,000 that Midwest Markets agreed, in the November 20, 2001 Stipulation with Produce One, to set aside as a portion of the amount owed by the debtor to Produce One on its PACA claim; or (2) the

\$6,706.48 in funds that were in the Thorne Grodnik trust account and that were transferred to the Thorne Grodnik operating account on June 19, 2002, in partial payment of the fees and expenses approved by this bankruptcy court on December 21, 2001. Because it seems clear that there are insufficient assets to cover both the PACA claim held by Produce One and any other claims, the court must determine the priority of the creditor's PACA claim and the attorney's administrative claim.

The Perishable Agricultural Commodities Act requires a PACA dealer who receives perishable agricultural commodities to hold that produce and the sale proceeds from that produce "in trust for the benefit of all unpaid suppliers or sellers of such commodities . . . until full payment . . . has been received." 7 U.S.C. § 499e(c)(2); see *Greg Orchards & Produce, Inc. v. Roncone*, 180 F.3d 888, 890 (7th Cir. 1999). The Act therefore creates a statutory trust for the benefit of the unpaid produce suppliers. The PACA "trust . . . requires the produce buyer to hold the proceeds from its sales of produce and use them to pay suppliers before using those funds to pay its . . . other liabilities." *Greg Orchards*, 180 F.3d at 890 (quoting *Goldman Fruit & Produce Co. v. Lombardo Fruit & Produce Co. (In re Lombardo Fruit and Produce Co.)*, 12 F.3d 806, 809 (8th Cir.1993)).

The trust is created by operation of law whenever a dealer receives and accepts perishable commodities. See 7 C.F.R. § 46.46(e)(2). Nonetheless, to preserve its PACA trust rights, a supplier must comply with the notice requirements set forth at 7 U.S.C. § 499e(c)(3), (4) and 7 C.F.R. § 46.46(f). Properly preserved, trust rights are superior to the interests of secured creditors.

Id. at 890-91 (citing cases).

In its Memorandum of Decision and Judgment, entered on April 4, 2002, the court found that Midwest Markets is a produce dealer under PACA and that Produce One is a produce supplier that complied with PACA's notice requirements. See R. 428 at 16. It determined that Produce One's claim was allowed as a priority PACA trust asset and that it was secured by PACA's floating trust lien for perishable agricultural commodities. Under the PACA trust, all the assets relating to the produce, including the receivables and proceeds generated from it, were to be held in trust for the benefit of the unpaid seller until full payment had been received. See *id.* In a footnote to the Conclusion of its Memorandum of Decision, the court set forth the legal treatment accorded to PACA trust assets in a bankruptcy case:

When a dealer files bankruptcy, the PACA trust assets in the possession of the dealer-debtor are excluded from the bankruptcy estate. *See Tom Lange Co., Inc. v. Kornblum & Co., Inc. (In re Kornblum & Co., Inc.)*, 81 F.3d 280, 284 (2d Cir. 1996); *In re Ozcelik*, 267 B.R. 485, 490 (Bankr. D. Mass. 2001); *In re Long John Silver's Restaurants, Inc.*, 230 B.R. 29, 32 (Bankr. D. Del. 1999). A bankruptcy trustee may administer a PACA trust *res* for the benefit of the PACA claimants solely. *See In re Oberlies*, 94 B.R. 916, 922 (Bankr. E.D. Mich. 1988). The plaintiff has priority over even secured creditors with respect to any produce-related assets; however, if the debtor's remaining produce-related assets are insufficient to satisfy the debt, the plaintiff has no special priority with respect to other assets. *See JC Produce, Inc. v. Paragon Steakhouse Restaurants, Inc.*, 70 F.Supp.2d 1119, 1123 (E.D. Cal. 1999).

Id. at 16 n.9.

The cases uniformly hold that PACA trust funds are not property of the bankruptcy estate. *See, e.g., Hiller Cranberry Prods., Inc. v. Koplovsky*, 165 F.3d 1, 5 (1st Cir. 1999); *Texas Comptroller v. Megafoods Stores, Inc. (In re Megafoods Stores, Inc.)*, 163 F.3d 1063, 1066 n.4 (9th Cir. 1998); *In re Churchfield*, 277 B.R. 769, 776 (Bankr. E.D. Cal. 2002); *In re Ozcelik*, 267 B.R. at 489-90. The funds are held in trust for the trust beneficiaries, namely the produce suppliers who are “entitled to priority ahead of all other creditors.” *East Coast Potato Distributors v. Grant (In re Super Spud, Inc.)*, 77 B.R. 930, 931 (Bankr. M.D. Fla. 1987). “[T]he intended purpose of Congress in enacting the PACA’s trust provision was to provide unpaid produce sellers with greater protection from the risk of default by buyers by placing them ahead of other creditors in priority to collect from the PACA trust.” *In re Ozcelik*, 267 B.R. at 492 (internal citation omitted); *see* 7 U.S.C. § 499e(c). Produce One claims its priority position and insists it should collect the \$25,000 that Midwest Markets agreed to set aside for the PACA claim or the \$6,700 paid to debtor’s counsel for its administrative claim of fees and expenses.

At first glance, it appears that Produce One has priority over both amounts. In a case in which “[v]irtually all of the assets of the bankruptcy estate are comprised of the proceeds from the collection of debtor’s accounts receivable,” *In re Super Spud, Inc.*, 77 B.R. at 931, this court can find, as did the Florida Bankruptcy Court in *Super Spud*, that those proceeds never became part of the debtor’s bankruptcy estate and that the beneficiaries of that PACA trust were entitled to “complete priority in payment as to all the assets of the debtor, ahead of the claims of creditors who have valid security interests, ahead of the administrative costs and expenses incurred in this court, and ahead of all other priority and general creditors.” *Id.* at 932 (citing cases). In that

case, as in this one, the PACA creditors' claims exceeded the amount of assets in the estate; for that reason, the *Super Spud* court held that the PACA trustee was obligated to collect and distribute those assets without reimbursement for his own expenses. *Id*; see also *Dairy Fresh Foods, Inc. v. Ramette (In re Country Club Market, Inc.)*, 175 B.R. 1005, 1010 (D. Minn. 1994) ("The burden is upon the wholesale produce dealer to ensure that trust assets are maintained.").

This court finds that Midwest Markets had a duty to maintain the trust assets and to set aside the \$25,000 for the benefit of its unpaid supplier, Produce One. The creditor has a priority claim, in the amount of \$25,000, held explicitly for Produce One in partial payment of its PACA claim. Those funds were designated specifically to be PACA funds that derived from the produce itself, its accounts receivables, or the sale proceeds of perishable goods. Both the PACA statute, 7 U.S.C. § 499e(c)(2), and this court's Order of April 4, 2002, require the turnover of those PACA trust assets from the dealer Midwest Markets to the unpaid supplier Produce One. The court therefore grants Produce One's Motion to Compel Distribution of \$25,000 held by the debtor.

The court now considers whether Thorne Grodnik should be compelled to disgorge the administrative expense of \$6,706.48, which was partial compensation of the fees and expenses awarded to it by the court. As the cases make clear, the beneficiary of a PACA trust has priority ahead of all other creditors and even ahead of claimants of administrative costs and expenses. See *In re Country Club Market, Inc.*, 175 B.R. at 1010. Courts have found that PACA trust assets cannot be used to pay attorney's fees. See, e.g., *Dimare Homestead, Inc. v. Fair (In re Fair)*, 134 B.R. 672, 676 (Bankr. M.D. Fla. 1991) (finding that payment of attorney's fees unfairly reduces PACA estate assets at expense of PACA creditors). For example, the Second Circuit Court of Appeals affirmed the denial of attorney's fees and held that a PACA trustee, who was a produce dealer, "may not use PACA funds to pay attorney's fees incurred in collecting accounts receivable held in trust for a seller of perishable agricultural commodities." *C. H. Robinson Co. v. Alanco Corp.*, 239 F.3d 483, 488 (2d Cir. 2001). In that case Alanco, a PACA produce dealer, ceased its operations and liquidated. It then settled a lawsuit and recovered \$78,000, its sole asset. With that asset, the dealer then paid the PACA claim held by Robinson, the

unpaid produce seller. The dealer's attorney then asserted that, through his services, the dealer had collected the accounts receivable that became the PACA trust funds. He claimed that he was entitled to be paid out of the trust *res*. The appellate court disagreed. It found that the dealer, as a PACA trustee, was not authorized to withdraw funds from the PACA trust *res* to pay administrative expenses incurred in collecting trust funds. Because PACA's trust provision required the dealer to hold the produce proceeds in trust for the benefit of the seller until he was paid in full, the court concluded that the dealer could not pay its attorney before the suppliers were paid.

Allowing a defunct PACA trustee to pay other creditors with PACA funds before the seller is paid in full would frustrate this purpose [of protecting sellers and suppliers of perishable agricultural commodities until full payment of sums due have been received], and would be contrary to the language of PACA and its accompanying regulations. PACA trust beneficiaries are entitled to full payment before trustees may lawfully use trust funds to pay other creditors.

Id. at 488; *see also Six L's Packing Co., Inc. v. Post & Taback, Inc.*, 132 F.Supp.2d 306, 309 (S.D.N.Y. 2001) (holding that fees of attorneys who served as receivers of the trustee's PACA assets could not be paid from PACA funds). It is clear from the case law, therefore, that PACA trust beneficiaries like the supplier Produce One take priority in payment as to all the trust assets of dealers such as the debtor Midwest Markets, ahead of the claims of creditors who have valid administrative claims, such as the attorneys of the dealer debtor.

Critical to this line of cases, however, is the statutory definition of what comprises PACA trust assets: “[p]erishable agricultural commodities received by a commission merchant, dealer, or broker in all transactions, and all inventories of food or other products derived from perishable agricultural commodities, and any receivables or proceeds from the sale of such commodities or products.” 7 U.S.C. § 499e(c)(2). Therefore, assets not traceable to those commodities listed in the statute are not encompassed by the PACA trust. *See In re Ozcelik*, 267 B.R. at 491 (“Of course, while such priority applies to all of a buyer's produce-related assets, it does not apply to other non-trust assets.”) (citing cases). When a party such as the Thorne Grodnik law firm opposes the creditor's claim that its fees and expenses are subject to the PACA trust, it has the burden of proving that particular assets or funds are not part of the trust. *See Callaway Produce Co., LLC, v. Bear Kodiak Produce, Inc. (In re Bear Kodiak Produce, Inc.)*, 283 B.R. 577, 583 (Bankr. D. Ariz. 2002); *In re Ozcelik*, 267 B.R. at 489.

Thorne Grodnik successfully shouldered that burden. It explained that its court-approved compensation payments came from a trust account funded by a loan to the debtor from PWNC, LLC, an affiliated company of Midwest Markets. Those funds were lent expressly to pay Thorne Grodnik’s retainer, fees and expenses. *See* R. 451 at ¶ 11; R. 455 at ¶¶ 3, 13. It declared that it “has received no money from Debtor which would be proceeds of merchandise provided to Debtor by Produce One and sold by Debtor.” R. 451 at ¶ 12.

The court finds that Produce One has not produced any evidence that the trust account funds were PACA trust assets. Nothing in the record suggests that those funds were produce-related assets – the perishable goods themselves, accounts receivables derived from them, or the sale proceeds from those commodities. *See In re Lombardo Fruit & Produce Co.*, 12 F.3d at 112 (citing 7 C.F.R. § 46.46(c)). “[P]roceeds from other sources are not within the trust’s rubric.” *Id.*; *see also In re Churchfield*, 277 B.R. 769, 775-76 (Bankr. E.D. Cal. 2002) (finding that the preferential transfers recovered by trustee were property of the estate, not subject to the PACA trust). The proceeds of a post-petition loan to the debtor, earmarked specifically for legal services, do not resemble PACA trust assets in any way. The court finds that, because the creditor failed to rebut the evidence that no PACA trust assets were used, the law firm has demonstrated to the satisfaction of the court that its compensation did not derive from the trust assets of the debtor. Accordingly, the court denies the creditor’s Motion in the Alternative to Partially Disgorge Fees and Expenses.

Conclusion

For the reasons presented above, the court grants in part and denies in part the Motion to Compel Distribution or, in the Alternative, to Partially Disgorge Fees and Expenses, filed by Produce One, a creditor of the debtor Midwest Markets LLC.

SO ORDERED.



HARRY C. DEES, JR., CHIEF JUDGE
UNITED STATES BANKRUPTCY COURT